Mizuho Flash: Malaysia

Economics & Strategy | Asia ex-Japan

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Key Takeaways from Budget 2025

In a Nutshell: Initiatives under Budget 2025 were broadly in-line with theme of promoting growth, driving reforms and prospering the *rakyat*. Notable initiatives include expansion of sales and services tax, introduction of tax on dividends income, updates to RON95 targeted fuel subsidy, increase in cost-of-living measures and a raise in minimum wage. Overall, we see the budget as a mildly positive to economic growth while presenting upside risks to inflation outlook. On the fiscal front, we see some risks of fiscal slippages to achieve a fiscal deficit of 3.8% as the revenue estimates appear slightly optimistic.

On 18 October 2024, PM Anwar revealed Budget 2025 "Reinvigorating the Economy, Driving Reforms and Prospering the Rakyat". In-line with the theme, the Budget featured a slew of measures focused on labour reforms and improving social welfare, among others, with an eye of consolidating fiscal balances. A list of key initiatives is summarised in the table below.

Labour Reforms	• **Minimum wage increase:** The minimum wage will rise from RM1,500 to RM1,700 starting 1 Feb 2025, but businesses with fewer than five employees will be granted a 6-month extension • **Progressive Wage Policy:** Will be fully enforced next year, following the pilot programme in June 2024. Allocated Rm200mn and estimated to benefit 50,000 workers. Another RM250mn allocated to increase the participation of more hardcore poor individuals in the People's Income Initiative to boost their income. • **Broadening labour force through targeted tax relief:** Additional tax deductions of up to 50% for hiring women returning to the workforce, implementing flexible work arrangements and granting paid caregiver leave.
Improving Social Welfare	• **Affordable education/healthcare and housing:** Increased income tax deductions for education and medical insurance premiums; first-time homebuyers to receive tax relief of up to RM7,000 on housing loan interest for properties up to RM750,000. • **More cash handouts to more lower-income households:** In addition to money allocated for price control measures on necessities, allocation for Sumbangan Tunai Rahmah (STR) and Sumbangan Asas Rahmah (SARA) increased to RM13bn or 0.62% of GDP from RM10bn in 2024. In 2025, 4.1m STR households will receive SARA amounting to RM100 per month, up from 700k this year, while STR singles was increased to RM600 from RM350. Cash assistance allocation to senior citizens and child assistance were also raised.
Improving Infrastructure	• Focus on financing projects that are "*rakyat*-centric" and the facilities that support industrial areas according to state priorities. • Planned projects include building infrastructure (e.g. expressways, hospitals, flood mitigation projects, upgrading works) and developing industries such as a high-tech green hub and automotive hub. • Increase in grants to Sabah and Sarawak to RM600m each.
Consolidating Fiscal Balances	• **Expansion of Sales and Services Tax:** Details pending but would include commercial services, in particular those with fee-based model, and non-essential food items (e.g. imported premium salmon and avocados).

	• **Dividend Taxation:** Dividend income exceeding RM100,000 received by individual shareholders will be taxed at a rate of 2% effective YA2025. Exemptions may be provided for dividend income from government savings (e.g. EPF). • **Implementation of global minimum tax:** Applicable to multinational companies with an annual global turnover of at least EUR750m. • **RON95 subsidy rationalisation:** Scheduled to be rolled out in mid-2025. • **Education subsidy rationalisation**: Phased reduction in education subsidies for top 15% income earners. *Carbon tax on steel and iron industry would only be rolled out in 2026.

Economic: Net Positive

While the overall position of a declining fiscal deficit ordinarily indicates a contractionary fiscal stance, we still see potential for Budget 2025 to exert a mildly expansionary impact to growth.

Operating expenditure (net of subsidies, grants and debt servicing burden) is still expected to grow by 9.3% in 2025, slower than the 13.7% in 2024. This continues to imply that **government consumption** will remain supportive of GDP growth, albeit a more moderate pace.

While development expenditure is slated to remain **flat** at RM86bn for Budget 2024 which is presumably **neutral** on growth, multipliers are likely higher amid stronger government efforts to stem up investment flows through improved partnership and initiatives (e.g. Johor-Singapore Special Economic Zone, tax incentives for foreign-local joint ventures). Consequently, a small impulse from **public investment** is still envisaged.

In addition, various measures announced during Budget 2025 such as the STR and SARA alongside Progressive Wage Policy are also expected to support economic activity. Specifically, household spending should also remain supported as the targeted nature of the enhanced cost of living initiatives imply that recipients would be liquidity constrained households and impart robust economic multipliers. Furthermore, subsidy rationalisation may not have a substantial contractionary impact given that they are applied onto wealthier individuals who may not cut back on their overall consumption. All in, we expect measures announced in Budget 2025 to deliver an expansionary impulse and continue to contribute to 0.6%-point of growth and aid overall GDP growth to be around the midpoint of the government's 4.5-5.5% projection in 2025.

Inflation: Moderate Upside Risks

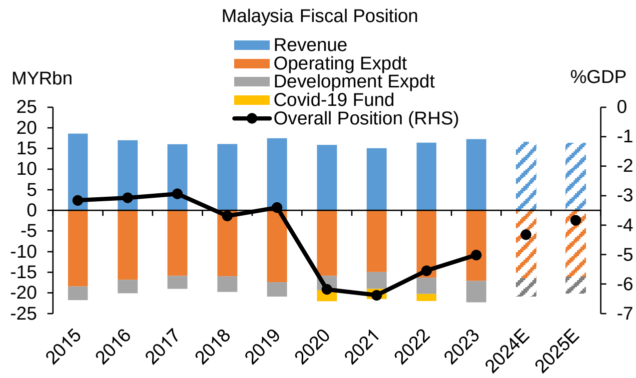
Admittedly, Budget 2025 presents upside risks to inflation, particularly on a) the expansion of scope of SST (details await), b) RON95 subsidy rationalisation (expected to be implemented in mid-2025) and c) increases to minimum wages and rollout of progressive wage system. However, given the momentum of price increases this year considering similar developments in Budget 2024[1], we expect upside risks to be moderate.

Fiscal Balance: Constructive Step Forward, Albeit Risks of Misses

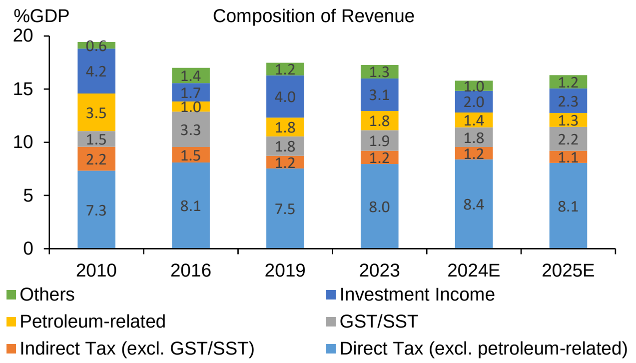
Budget 2025 is targeting a deficit of 3.8% of GDP from 4.3% this year. This represents another step towards fiscal consolidation towards a target of 3.5% by 2026 under the MTFF. **While we agree that the**

[1] Budget 2024 expanded the scope of Sales and Services Tax and the diesel subsidy rationalization was rolled out in May 2024. While Budget 2024 only introduced the progressive wage system, inflation remains moderate despite robust wage growth (as proxied by increase in formal sector wages) in 2024.

commitment towards fiscal consolidation has been steadfast, we express some reservations on the 2025 target, in particular the revenue growth estimate. Revenue collection in 2025 is expected to increase further to RM340bn, or 16.3% of GDP (and RM344bn, or 16.5% of GDP after accounting for Budget 2025 measures) . This represents a 5.5% (6.8%) increase from the revised revenue projection of RM322bn for 2024 (initial budget estimate: RM308bn), which is higher than the average actual revenue growth for 2016-2019 of ~5.0%.



Sources: CEIC: Malaysia MOF; Mizuho



Note: Petronas dividends is categorised under investment income.
Sources: CEIC; Mizuho

We are rather circumspect on the revenue estimate for 2025 for the following reasons:

- Distributional effects of wage increases. Despite an average 5.9% YoY increase in median formal sector wages for YA2023, personnel income tax revenue for 1H'24 was 12.2% lower compared to a year ago. While there could be seasonal effects at play and we do see indications of revenue catch-up in July and August, distributional effects across income tiers may mean that 2025 revenue growth may fall short despite Q1'24 (applicable for YA2024) seeing median formal sector wages on average 7.7% higher YoY.
- Revenues from corporate income tax may not be as stellar: Revenue from corporate income tax is expected to grow 7.4% YoY for 2024 and a further 8.1% for 2025. However, YTD corporate income collection has been lacklustre, falling 14.6% from a year ago in 1H'24. Notwithstanding some seasonal effects at play, earnings of stocks in KLCI index for YA2023 do not provide much optimism. Instructively, earnings for 2023 are estimated to be about 60% lower YoY. Notwithstanding this, there is potential for corporate income tax growth to come in at 8.1% for 2025 given earnings growth of ~21% YoY YTD, but we think that this growth will be from a lower base (i.e. risk that growth target for 2024 is not met). Consequently, in level terms, revenues should be adjusted downwards. And given that corporate income tax revenue is the largest revenue source and constitute ~30% of total revenue, there would be some material impact on revenues.

Notwithstanding the above, we think that estimates of SST, which constitute ~12-13% of GDP to be reasonable. Indirect tax revenue accrued from sales and services tax in 1H'24 is already 17.6% higher YoY. Hence, the growth estimate for 14.2% YoY for 2024 (and 26.5% YoY after accounting for Budget 2025 measures) appears reasonable, considering some base effects for the first few months, resilient consumer spending, and assuming a similar (or bigger) size of additional capture of taxable base under this round of expansion. Even as **we await details[2], we posit that this expansion business-to-business fee-based services and financial brokerage services as possible groups which officials will consult with.** Using monetary intermediation as a proxy for financial brokerage services, fee-based financial services

[2] After Budget 2024's expansion of scope, there are 9 broad groups of taxable services, as follows: a) accommodation, b) food and beverages, c) nightclubs, dance halls, health & wellness centres, karaoke etc., d) private club, e) golf club and golf driving range, f) betting and gambling, g) professions, h) credit card and charge cut, and i) delivery services, logistics and other service providers.

along could add revenue of ~0.1% of GDP based on a SST rate of 8%.

Federal Government Revenue, 2023 - 2025

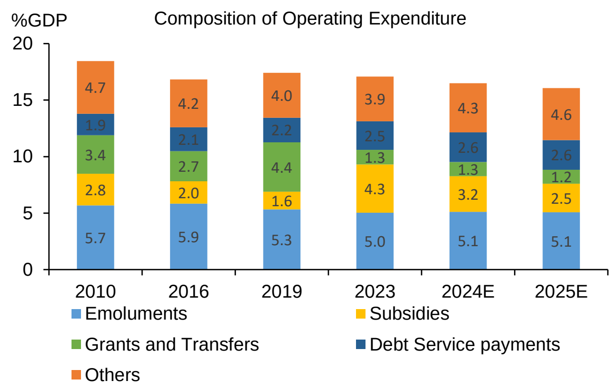
Component	RM Million				Change (%)				Share (%)			
	2023	2024	2025 [1]	2025 [2]	2023	2024	2025 [1]	2025 [2]	2023	2024	2025 [1]	2025 [2]
Tax Revenue	**229,185**	**241,035**	**259,037**	**263,425**	**9.8**	**5.2**	**7.5**	**9.3**	**72.8**	**74.8**	**76.3**	**76.6**
Direct Tax	171,336	177,060	188,799	188,166	11.6	3.3	6.6	6.3	54.4	54.9	55.6	54.7
of which:												
Corporate	91,743	98,540	106,478	N/A	11.7	7.4	8.1	-	29.1	30.6	31.4	-
Individuals	37,770	40,776	43,970	N/A	11.8	8.0	7.8	-	12.0	12.7	12.9	-
Petroleum-related	26,096	21,750	20,742	N/A	11.4	-16.7	-4.6	-	8.3	6.8	6.1	-
Indirect tax	57,849	63,975	70,238	75,259	4.6	10.6	9.8	17.6	18.4	19.9	20.4	21.9
of which:												
SST	35,463	40,914	46,743	51,742	13.1	15.4	14.2	26.5	11.3	12.7	13.8	15.0
Excise duties	13,144	13,684	13,795	13,819	4.7	4.1	0.8	1.0	4.2	4.3	4.1	4.0
Import Duty	3,037	3,027	3,269	3,269	-4.9	-0.3	8.0	8.0	1.0	0.9	1.0	1.0
Export Duty	2,039	1,974	1,955	2,195	-22.2	-3.2	-1.0	11.2	0.6	0.6	0.6	0.6
Non-tax Revenue	**85,774**	**81,015**	**80,669**	-	**0.2**	**-5.5**	**-0.4**	-	**27.2**	**25.2**	**23.7**	-
of which:												
Licences and permits	16,741	16,547	16,659	-	7.1	-1.2	0.7	-	5.3	5.1	4.9	-
Investment income	55,824	49,321	48,213	-	-4.1	-11.6	-2.2	-	17.7	15.3	14.2	-
Total revenue	**314,959**	**322,050**	**339,706**	**344,094**	**7.0**	**2.3**	**5.5**	**6.8**	**100.0**	**100.0**	**100.0**	**100.0**
Share of GDP	**17.3**	**16.5**	**16.3**	**16.5**								

Source: Ministry of Finance, Mizuho

[1] Excluding Budget 2025 measures; [2] Estimates after including Budget 2025 measures

Meanwhile, expenditure is estimated at RM421bn, 6.9% higher compared to 2024's budget of RM394bn. The increase is due to a 10.3% increase in allocation for operating expenditure, at RM335bn (2024: RM304bn) while development expenditure is 4.4% lower (2024: RM90bn). The higher-than-average increase in operating expenditure appears reasonable considering the increased in spending to achieve social objectives.

On the RON95 targeted petrol subsidy rationalisation, PM Anwar suggested that it would be targeted towards 15% of the population. PM Anwar has identified "wealthy individuals, foreign nationals and businesses" as the likely target for reduced subsidies, given that these groups constituting 15% of consumers but benefit "disproportionately from 40% of the RON95 subsidy, amounting to RM8 billion". In the extreme (and unlikely scenario) where petrol subsidies are *fully* removed for these groups, we estimate savings of ~0.16% of GDP (or 0.08% in 2025 given that this will only be rolled out in mid-next year). But in reality, we estimate savings is likely to only be <0.1% in 2025 given possible leakages, and the almost one-year delay in rollout may allude to implementation issues. As a comparison, the diesel rationalisation programme introduced earlier this year is expected to save about RM4bn annually (~0.2% of GDP).



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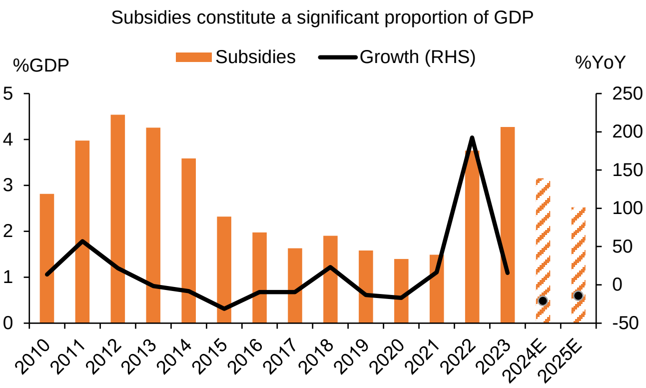

Sources: CEIC; Ministry of Finance; Mizuho

All in, Budget 2025 is commendable in its targeted initiatives towards promoting inclusive and sustainable growth. It also demonstrates PM Anwar's administration commitment towards fiscal consolidation. Nonetheless, subsidy expenditure is expected to still remain high, and rather optimistic revenue targets risk missing the fiscal deficit target.

As an aside, we think that the ongoing negotiations between Petronas, Sarawak and federal government on the LNG rights in Sarawak adds further to downside risks, but risks should be moderate for 2025 at least. Admittedly, should Sarawak take back full control of its natural resources, government revenue could take an impact on reduced dividends from Petronas (Petronas paid the federal government RM40bn in dividends in 2023). Direct tax would be less impacted since both Petronas and Sarawak state-owned Petros are subject to corporate tax), but it would be extremely unlikely that ongoing discussions do not have the fiscal situation in mind. A plausible scenario (in the event that Sarawak does take back control of its resources) could be Sarawak paying for some of its infrastructure development, which would mean a decrease in development expenditure.

Debt Management: Broadly Neutral

Debt-to-GDP ratio is projected to remain around 64% by end of 2024 and 2025, against 63.1% of GDP as at end-June. This means that the Medium-Term Fiscal Target (MTFF) for debt-levels to be 60% of GDP by 2026 looks unlikely to be attainable. Nonetheless, we do not think that this will be a large negative to investor sentiments given the administration's commitment to control spending via fiscal consolidation, robust economic growth of the economy and a steady BNM.

MYR Outlook: Constructive

All in, Budget 2025 affirms our constructive view on the MYR, which has a greater relative upside potential on reduced political risk premium, semiconductor upcycle, supportive household consumption and positive developments on the fiscal front.